

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Updating Part 1 Competitive Bidding Rules)	WT Docket No. 14-170
)	
Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions)	GN Docket No. 12-268
)	
Petition of DIRECTV Group, Inc. and EchoStar LLC for Expedited Rulemaking to Amend Section 1.2105(a)(2)(xi) and 1.2106(a) of the Commission's Rules and/or for Interim Conditional Waiver)	RM-11395
)	
Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures)	WT Docket No. 05-211
)	
To: The Commission		

REPLY COMMENTS

COUNCIL TREE INVESTORS, INC.

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March 6, 2015

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SUMMARY

In these Reply Comments, Council Tree Investors, Inc., a company that has long been active in spectrum auction proceedings at the FCC, briefly reviews the background of the FCC's Designated Entity ("DE") program, debunks two myths currently trying to gain circulation that DEs should only make small bids at auction and that DE bidding credits damage taxpayers, and offers an illustrative analysis of why the comments submitted by pro-DE commenters in this proceeding have merit, whereas those offered herein by large incumbents and their supporters do not. These reply comments also show that the robust, record-setting results of recently-completed Auction 97 compellingly illustrate why a viable DE program very much enhances competition, benefits the American consumer and taxpayer, fulfills the mandates of Section 309(j) of the Communications Act, and serves the overall public interest. Changes to facilitate the growth of the DE program should be adopted. Those which are intended to clip the DE program's wings should be rejected.

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To: The Commission

REPLY COMMENTS

Council Tree Investors, Inc. ("Council Tree"), by its attorneys, hereby submits its reply comments in the above-captioned proceeding.¹

I. Background.

Against a historical backdrop of more than twenty years' duration, the FCC has undertaken in the above-captioned proceeding a review of the competitive bidding rules which

¹ Council Tree is an investment company organized to identify and develop communications industry investment opportunities for the benefit of small businesses and new entrants, including those owned by members of minority groups and women. The company brought the legal challenge to the 2006 DE Rules (defined below) which vacated two of those three rules. *See Council Tree Commc'ns, Inc. v. FCC*, 619 F.3d 235, 259 (3d Cir. 2010), *cert. denied sub nom. Council Tree Investors, Inc. v. FCC*, 131 S. Ct. 1784 (2011) ("*Council Tree*"). The principals in Council Tree collectively own an indirect 5.3% minority equity interest in Northstar Manager LLC, the manager and controlling shareholder of Northstar Spectrum, LLC, in turn the manager and controlling shareholder of Northstar Wireless LLC, which participated in Auction 97.

govern spectrum auctions. In August 1993, Congress authorized the FCC to distribute spectrum through auctions.² At that time, Congress charged the Commission with the responsibility of creating an auction design that, among other things, counterbalances auctions' tendency to favor deep-pocketed bidders, such as large incumbent wireless companies that possess massive marketplace advantages of scale. Congress embedded this vital objective within Section 309(j) in two primary ways – Section 309(j) tasked the FCC with the obligation to widely distribute licenses among small businesses, including minority- and women-owned businesses, and rural telephone companies,³ and the statute directed the agency to avoid an excessive concentration of licenses.⁴ In the early years following passage of the legislation, the FCC utilized various measures in pursuit of these key objectives (e.g., conducted auctions that were closed to the large incumbents, tried installment payment plans). By 2006, however, the agency had eliminated all incentives except for the award of bidding credits in varying percentages to small businesses known as Designated Entities (“DEs”)⁵ as the sole tool it would employ in an effort to level the auction playing field for those trying to compete against the large incumbents.

In 2006, on the doorstep of Auction 66, without providing advance notice and the opportunity to comment, the FCC adopted a series of severe new DE restrictions (the “2006 DE Rules”) that crippled DEs’ business plan flexibility and sent potential DE strategic partners and investors streaming for the exits, effectively eviscerating the DE program’s ability to produce

² See Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 6002, 107 Stat. 312, 387-392, codified at 47 U.S.C. § 309(j) (“Section 309(j)”).

³ 47 U.S.C. § 309(j)(3)(B).

⁴ *Id.*

⁵ The FCC has specified varying gross revenue tests which define different levels of qualifying small business DEs.

any meaningful level of auction competition from DEs.⁶ With the 2006 DE Rules in place, major spectrum Auctions 66 (2006) and 73 (2008) witnessed historically low levels of DE participation⁷ and parallel domination by the large incumbents. In 2010, in *Council Tree*, the United States Court of Appeals for the Third Circuit vacated two of the most onerous of the 2006 DE Rules, setting the stage for the return of viable DE participation in Auction 97.

In the fall of 2014, as planning for the Broadcast Incentive Auction (“BIA”) moved forward, the FCC commenced the above-captioned reexamination of its competitive bidding rules. The FCC therein undertook a careful reexamination of the legal underpinnings of the DE program as part of an exploration of how best to enhance DE effectiveness in auctions and made several tentative endorsements, such as repeal of the AMR Rule, the one remaining 2006 DE

⁶ The three primary 2006 DE Rules were:

(1) the “Ten Year Hold Rule,” which doubled the unjust enrichment penalty repayment period after auction from five to ten years and made corresponding changes in the related schedule of graduated repayment penalties over those ten years, including the imposition of a 100 percent bid credit repayment obligation (plus interest) during the first five years. *See* 47 C.F.R. § 1.2111(d)(2)(i) (2006) (vacated 2010);

(2) the “50 Percent Rule,” which eliminated DE eligibility altogether for any entity that leased or resold (including on a wholesale basis) to third parties more than 50 percent of the aggregate spectrum capacity won at auction. *See* 47 C.F.R. § 1.2110(b)(3)(iv)(A) (2006) (vacated 2010); and

(3) the “Attributable Material Relationship Rule” (hereinafter referred to as the “AMR Rule”), which effectively limited DEs to leasing or reselling (including on a wholesale basis) to any single third party no more than twenty-five percent of the aggregate spectrum capacity won at auction. The rule accomplished this result by attributing to each DE the gross revenues of any company to which it leased or resold this amount of spectrum capacity, which would in most cases have the effect of putting the DE’s gross revenues above the maximum level permitted for DE status eligibility. *See* 47 C.F.R. § 1.2110(b)(3)(iv)(B) (2006).

⁷ DEs, for example, won only 4 percent of the total value of the licenses sold in Auction 66 and even less, just 2.6 percent of that value, in Auction 73. *See Council Tree*, 619 F.3d at 248.

Rule which continued to hamper DEs' ability to participate robustly in spectrum auctions. The FCC also posed a series of questions on such issues as whether to increase DE bidding credit percentages and whether to increase qualifying DEs' gross revenue thresholds.

What began in October 2014 as a high-level FCC exercise in evaluating potential changes to the Designated Entity ("DE") Rules in advance of the BIA also created, by the extended deadline of February 20, 2015, an opportunity for comment on the actual performance of DEs in the AWS-3 Auction 97 which concluded on January 29, 2015. That auction raised a net total of \$41.3 billion, smashing pre-auction revenue estimates, to a chorus of acclaim.⁸ Among the February 2015 group of commenters, consensus emerged that the presence of DEs in Auction 97 was the driving force behind the record-setting amounts bid in Auction 97. A review of the comments confirms broad agreement on this key point. Sharp divergence emerged, however, over whether and how the existing DE Rules should be changed in advance of the BIA.

II. Several Myths Need to Be Pierced.

At the threshold, Council Tree believes it important to address two post-Auction 97 myths. The first is that the DE program is only supposed to facilitate small businesses making small bids in spectrum auctions. The second is that the award of bidding credits ultimately hurts taxpayers. Each myth is readily debunked.

A. The myth that DEs should only make small bids. Section 309(j)'s twin goals of wide license dissemination and avoidance of excessive license concentration would be gutted if the FCC designed a DE program merely to facilitate *small* auction bids by DEs (e.g., for small markets or small spectrum blocks). The FCC has long recognized the importance of this issue. That is, from its inception, the DE program has been designed to produce viable competition to

⁸ See Comments of the DE Opportunity Coalition ("DOC"), Feb. 20, 2015, at nn.29 & 30 and accompanying text.

the large incumbent companies that have the incentive and potential to dominate the auction landscape with their entrenched market positions and vast financial resources. Indeed, as far back as 1994, the FCC stated that:

First, we will structure our attribution rules to allow *those extremely large companies* that may not bid on [PCS] blocks C and F to invest in entities that bid on those blocks. . . . Second, *to encourage large companies to invest in designated entities* and to assist designated entities without large investors to overcome the additional hurdle presented by auctions, we will make bidding credits available to designated entities. . . .⁹

And, as the materials attached hereto (“Presentation”) makes clear, the history of the DE program demonstrates that billions of dollars in large DE bids have been made over the more than two decades since the adoption of Section 309(j), redounding to the benefit of competition and the public interest.¹⁰ In 2000, given its experience with ownership restrictions hampering DE success, the FCC purposefully eliminated DE minimum equity holding requirements in favor

⁹ *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, Fifth Report and Order, 9 FCC Rcd 5532, 5539 ¶¶ 14-15 (rel. July 15, 1994) (emphasis added).

¹⁰ See Presentation at 5. See also Comments of The Auction Reform Coalition (“TARC”), Feb. 20, 2015, at 4-9; DOC Comments at 12 n.34. As the Presentation also makes clear, large incumbents have themselves historically partnered with DEs. In this regard, it is noteworthy that in the rulemaking proceeding that led to the adoption of the 2006 DE Rules, large incumbents strongly defended the legality and public interest benefits of DE strategic alliances with large companies: “It is not clear what ills the Commission is attempting to redress in this proceeding.” Comments of Verizon Wireless, WT Docket No. 05-211 (Feb. 24, 2006) at 2. “The Further Notice fails to come close to demonstrating the requisite clear cut need for new restrictions on only DE applicants for spectrum that partner with specific carriers.” *Id.* at 16. “A DE can be bona fide even if it benefits from a large carrier’s investment; conversely, prohibiting investment by a large wireless carrier has nothing to do with ensuring a DE is bona fide.” *Id.* at ii. “T-Mobile does not believe that the changes [then] proposed to the DE rules are either warranted or wise.” Comments of T-Mobile USA, Inc., WT Docket No. 05-211 (Feb. 24, 2006) at 1. “[T]he proposed rule revisions will undermine Congress’s directive that the Commission prescribe regulations that ‘ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services.’ From the inception of the DE program, the Commission has recognized that small businesses lack the ability to bid for and win spectrum, much less construct wireless networks, absent significant financial resources and operational support from established companies.” *Id.* at 9 (quoting 47 U.S.C. § 309(j)(4)(D)).

of a controlling interest standard, predicated on analysis of de jure and de facto control.¹¹ Very recently, Commissioner Pai, in a statement otherwise criticizing certain aspects of Auction 97, acknowledged that a critical purpose of the DE program is to bring competition to the “large” incumbent companies.¹² Given these substantial and well-grounded public interest goals, it is hardly surprising that the DE program has historically favored (with the exception of the unfortunate reign of the 2006 DE Rules during the 2006-2010 period) strategic alliances between controlling party DEs and larger companies and investors. Realistic business plans necessarily depend on such strategic alliances with larger companies that can help provide the dollars necessary to fuel viable competitive bids at auction. Council Tree knows of no other business model by which DEs could realistically compete at the higher bid levels (e.g., in mid- and large-sized markets that need new entrant DE competitions).

B. The “damage to taxpayers” myth. Critics posit that taxpayers were hurt by the post-Auction 97 award of bidding credits.¹³ The basic math of Auction 97 teaches otherwise. Predictions in advance of Auction 97 estimated its proceeds at some \$18 billion.¹⁴ Those projections were logically predicated in part on the monetary results of the then-most recent large spectrum auctions, Auctions 66 (\$13.7 billion) and 73 (\$19.1 billion). But the overlooked wildcard was the resuscitation of the DE program after the 2010 court ruling in *Council Tree*. Incentivized by the DE bidding credit, and with a viable business plan again possible, DEs again

¹¹ See DOC Comments at n.42 and accompanying text.

¹² See *Statement of Commissioner Ajit Pai on Abuse of the Designated Entity Program*, Feb. 2, 2015, available at <http://www.fcc.gov/document/commissioner-pai-statement-abuse-designated-entity-program> (last visited Mar. 3, 2015) (“Pai Statement”).

¹³ See Pai Statement; Comments of MediaFreedom.org, Feb. 20, 2015, at 2; Comments of Thomas A. Schatz, President, Citizens Against Government Waste, Feb. 20, 2015, at 3.

¹⁴ See Presentation at 3 and accompanying text quoting Commissioner Clyburn.

entered the bidding pool and drove Auction 97 revenues toward true market value, some \$23 billion above the level that Auction 97 was positioned to find if DEs were still sitting on the sidelines. So, from the vantage point of the taxpayer, bidding credits to DEs produced a \$23 billion surplus over expected results. Phrased simply, the DE program is a money-maker for the taxpayer. This point has long been recognized by auction experts, and was well articulated in a 1996 article published in the Stanford Law Review:

The FCC's affirmative action has been criticized as a huge giveaway, but this article will show that the bidding preferences increased the government's revenues [in Auction 3] by 12% - an increase in total revenues of nearly \$45 million. Although at first blush it seems that allowing designated entity bidders to pay fifty cents on the dollar would necessarily reduce the government's revenue, we will show that *subsidizing designated entity bidders created extra competition in the auctions and induced the established, unsubsidized firms to bid higher. . . .*

The extra revenue the government earned from unsubsidized winning bidders . . . *more than offset the subsidy to the designated bidders.* Far from being a giveaway, affirmative action bidding preferences *induced competition that prevented established firms from buying the airwaves at substantial discounts. . . .*¹⁵

III. Analysis of the Sharp Divide in the Comments Over DE Rule Revisions Strongly Favors the Pro-DE Commenters.

As noted above, there is a major fault line in the comments over how to revise the DE Rules. Pro-DE commenters argued strongly that changes like AMR Rule repeal, increased DE bidding credit percentages, and increases in gross revenue thresholds for qualifying DEs are needed to encourage even more robust DE participation in the BIA than occurred in Auction 97. These commenters found restoration of a ten-year unjust enrichment penalty period, on the other hand, to be a complete non-starter, as history shows it would have the same devastating effect on

¹⁵ Ian Ayres & Peter Cramton, *Deficit Reduction Through Diversity: How Affirmative Action at the FCC Increased Auction Competition*, 48 STANFORD L. REV. 761, 762, 780 (1996) (emphasis added).

DEs as the very same rule (the Ten Year Hold Rule) did in 2006. Pro-DE commenters cogently showed that the presence of viable DE bidders in Auction 97 produced a classic “*win/win*,” in a manner consonant with Section 309(j)’s public policy goals (wide distribution of licenses and avoidance of excessive industry concentration). That is:

- **Marketplace competition won** because in Auction 97 DEs collectively acquired 25.9 percent of the auctioned spectrum, a substantial increase over the DE results of Auction 73. The flip side of this result is equally positive: in sharp contrast to Auction 73 (84.4 percent of the spectrum value went to the two largest incumbents), the trend toward concentration of licenses was at least mitigated.
- **The Treasury and taxpayers won**, as the dollars raised not only fund beneficiaries like FirstNet and the Spectrum Relocation Fund,¹⁶ but allow a multi-billion dollar payment to be made to the U.S. Treasury.¹⁷ Analysis indicates that the increase attributable to viable DE participation exceeded \$23 billion.¹⁸

Various pro-DE commenters take a well-supported, balanced approach in their comments. For example, DOC and TARC both take pains to set their pro-DE positions in historical context. DOC’s comments are particularly cogent in demonstrating how the revival of a viable DE program in advance of Auction 97 ultimately served the twin statutory goals of wide license dissemination and avoidance of excessive license concentration, and they illustrate through the interweaving of reports on interviews with DE entrepreneurs why past agency missteps (particularly the 2006 DE Rules) must not be repeated. TARC does an excellent job

¹⁶ See DOC Comments at nn.27 & 28.

¹⁷ See Presentation at 5.

¹⁸ \$23.3 billion is the excess of Auction 97’s \$41.3 billion net proceeds over the \$18 billion pre-auction analyst estimates. In addition, an apples-to-apples *AWS spectrum auction* comparison can be made between Auctions 66 and 97. 90 MHz of paired AWS spectrum was sold in Auction 66 (when the restrictive Rules sidelined DEs) for \$13.7 billion. In Auction 97, with viable DEs back in the bidder pool, 65 MHz of AWS spectrum (only 50 MHz of which was paired) sold for \$41.3 billion. *So, in Auction 97 the FCC received \$27.6 billion more than it received for 25 MHz less of AWS spectrum in Auction 66.*

both of reviewing examples of past DE successes and growth demonstrating how a vibrant DE program can facilitate competition, and of tying their recommendations to goals articulated by Congress (e.g., increased bidding credits for DEs).

In sharp contrast, on the other side of the comment chasm, large incumbent wireless companies and their supporters (“Incumbents”) generally seek to eliminate the flexibility DEs enjoyed in Auction 97 and in auctions *before* 2006 to ally themselves with larger companies. To accomplish their goal, the Incumbents propose a wide range of measures, the adoption of any one of which would be enough to put DEs back on the sidelines to which they were relegated for Auctions 66 and 73, where DEs would pose no competitive threat.¹⁹ But the only discernible support for their proposals is the Incumbents’ self-interest, making obvious the reason for their DE-debilitating requests – if they were to succeed in eliminating DE bidding at the higher levels, *they would be able to acquire much more BIA spectrum for much less money*. If any one of their proposals were to be adopted, Incumbents would walk away winners, to the demonstrable detriment of competition, the U.S. Treasury, the U.S. taxpayer, consumers, Section 309(j) mandates, and the overall public interest.

Specifically, the Incumbents offer a smorgasbord of ideas for how to change the DE program. As noted above, adoption of any of these proposals would devastate the DE program in advance of the BIA, as even a cursory review reveals.²⁰

One Incumbent suggests that the FCC not only preserve the AMR Rule, but “strengthen it to prohibit [DEs] from leasing more than 25 percent of their spectrum in the aggregate, across

¹⁹ These proposals represent an abrupt course reversal from the positions taken by large incumbents in the FCC proceeding that led to adoption of the 2006 DE Rules. *See supra* n.10.

²⁰ Council Tree does not endeavor to identify and rebut herein each and every proposal in the comments which imperils DEs’ future viability, but strongly urges the FCC to scrutinize and reject all such proposals.

one or more lessees.”²¹ This proposal not only flies in the face of the NPRM’s tentative endorsement of *repeal* of the AMR Rule,²² it goes far beyond even the vacated and discredited 50 Percent Rule which was improvidently and unlawfully adopted by the FCC in 2006.²³ If DEs were restricted to 25 percent leasing *in the aggregate*, DEs would effectively be required to find another use for the remaining 75 percent of their spectrum capacity,²⁴ an impossible hurdle for a new entrant hoping to find a realistic way to compete against entrenched incumbents, with their enormous marketplace advantages. Business plan flexibility provides essential “oxygen” to DEs. Without it, they cannot access capital and are doomed to failure. Adoption of this proposal would immediately staunch DEs’ flow of future capital and their ability to develop viable business plans based on industry-standard relationships.

²¹ See Comments of T-Mobile USA, Inc. (“T-Mobile”), Feb. 20, 2015, at 4.

²² Council Tree strongly supports AMR Rule repeal, and endorses the following comments on this issue: TARC Comments at 17-18; Comments of Competitive Carriers Association (“CCA”), Feb. 20, 2015, at 9; DOC Comments at 16-18; Comments of NTCA-The Rural Broadband Association (“NTCA”), Feb. 20, 2015, at 5-6; Comments of the Wireless Internet Service Providers Association (“WISPA”), Feb. 20, 2015, at 10-11.

²³ The Court in *Council Tree*, *supra*, for example, said of the 50 Percent Rule: “[T]he FCC does not appear to have thoroughly considered the impact of the extended [ten year] repayment schedule on DEs’ ability to retain financing.” 619 F.3d at 256 n.10. It further found that the Commission was “confused” about “the maximum period for which investors are willing to lock up their capital (before being able to liquidate the spectrum license, in the event the DE proves unprofitable). . . .” *Id.* Likewise, the court criticized the agency’s “inattention to the nature of the wireless wholesaling business,” in which a DE would “build and operate” new, wireless transmission facilities and then sell that new capacity to other existing companies, thereby promoting competition. *Id.* at 255 n.8.

²⁴ Implicit in such an approach is a desire to force new entrant DEs to start up a business with an outsized, immediate, and prohibitively expensive *retail* component and presence, which of course cannot realistically be accomplished in the face of incumbents’ ubiquitous storefronts, media advertisements, etc. Mandated retail service would also contravene the FCC’s obligation to identify and eliminate market entry barriers under 47 U.S.C. § 257.

Similarly unavailing is an Incumbent proposal that the FCC adopt a ten-year unjust enrichment period for DEs that calls for full reimbursement of all bidding credits, plus interest and a penalty, if a license acquired with a DE bidding credit is transferred anytime within the ten-year period.²⁵ This proposal goes beyond re-imposition of the Ten Year Hold Rule which had been criticized and vacated by the Third Circuit in 2010,²⁶ a rule which quite effectively shelved DE business plans for Auctions 66 and 73. While the Ten Year Hold Rule allowed for graduated bidding credit repayment during years 6 through 10, this new proposal would nail the DE coffin even more tightly shut. As multiple commenters have made clear,²⁷ re-imposition of the Ten Year Hold Rule, much less the more severe version advocated by the Incumbents, would be debilitating for investors and effectively end DE bidding at the higher levels. Council Tree strongly opposes its reinstatement and, indeed, any extension of the already more than adequate five-year unjust enrichment period currently in force.²⁸

Other Incumbent-suggested changes in the DE Rules would put DEs into an inescapable box from which they could never again threaten dominant positions in the industry. That is, limiting a DE's bidding credits to \$32.5 million in any given auction, and/or making attributable for gross revenue calculation purposes all ten percent or greater equity holders in a DE,

²⁵ See T-Mobile Comments at 5.

²⁶ *Council Tree*, 619 F.3d at 259.

²⁷ See CCA Comments at 10; DOC Comments at 26-33; Comments of Rural Wireless Association, Feb. 20, 2015, at 9-11; and WISPA Comments at 13-14.

²⁸ Other Incumbent proposals for new rules that would apply uniquely to DEs – a one year buildout activity rule, a 50% equity attribution rule, and a 25% minimum equity threshold rule – are bereft of any public interest justification. They are rather transparently designed to handcuff and disable DEs, to the direct benefit of the large incumbents.

regardless of who has control,²⁹ would completely block DEs' ability to find the large investors needed to mount a realistic new entrant challenge to large incumbents, and these proposals should be summarily rejected. Again, Incumbents mistake their own self-interest for that of the public. As noted above, from its inception, the DE program has recognized the need for DEs to align themselves with large companies if they are to provide effective competition to large, entrenched incumbents.

In viewing the Incumbents' comments as a whole, it is important to note what they do *not* say. That is, conspicuously absent from the Incumbents' comments is any review of the DE program's statutory roots or its impressive track record in introducing competition into the wireless space, nor do Incumbents acknowledge their relative dominance within the wireless industry. Rather, they elect to throw various suggestions against the FCC "comment wall," in the hope that one might stick. Much more is needed to prevail on such vital issues as are currently before the Commission in this proceeding.

* * *

The ultimate message derived from a review of the comments is simple. Positions advocated by pro-DE commenters are coincident with the public interest as articulated in Section 309(j), more than twenty years of auction history, and case precedent. Well-established public policy goals strongly favor financially robust auctions, increased competition through the dissemination of spectrum licenses to viable new entrants, and application of the "brakes" to the escalating consolidation of an already concentrated industry. Proposals advanced by the Incumbents, on the other hand, merely favor the private interests of the dominant companies,

²⁹ See Comments of AT&T, Feb. 20, 2015, at 17.


with ample downside risks for competition and consumers and no material counterbalancing factors.

IV. Conclusion.

Council Tree strongly urges the FCC to take action consonant with the views expressed herein.

Respectfully submitted,

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ATTACHMENT

Auction 97's Success Stems from New Entrant DE Competition

- 1. DE Bidders Were the Key Driver Behind the Record \$45 Billion Auction**
delivering an extra \$23 billion of proceeds to U.S. taxpayers, not costing \$3 billion
- 2. Continues a 21-Year String of FCC-Backed DE Innovation and Competition**
(think of T-Mobile as a model → started and grew as a DE)
- 3. Unsurprisingly the DE Critics Are Large Wireless Incumbents**
who dislike high price (fair value) auctions and disruptive new entrant competitors



March 6, 2015

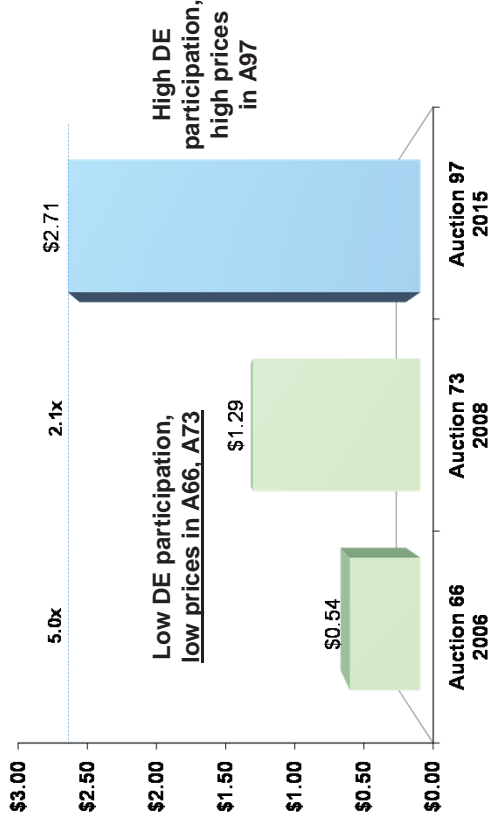
Introduction

Council Tree applauds the FCC for its record-breaking success in the \$45 billion Auction 97

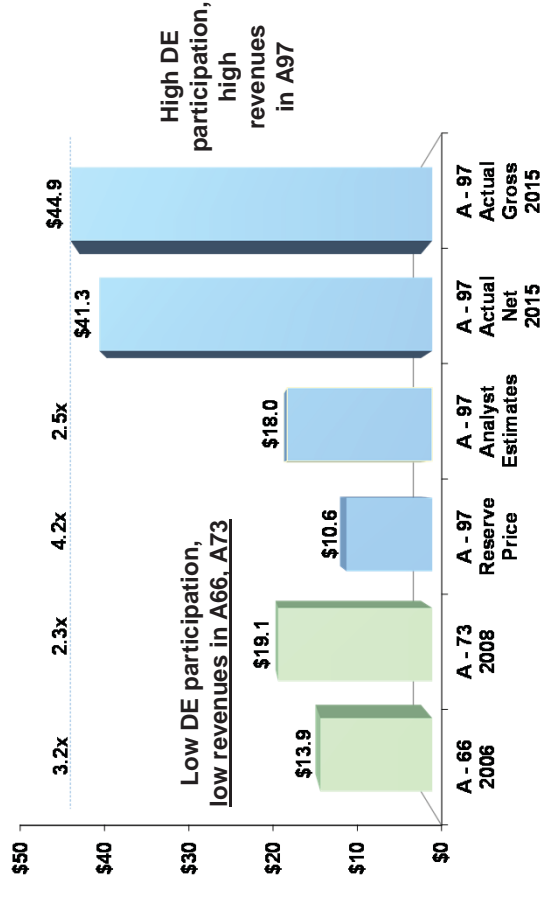
- ▶ **Auction 97 has been unanimously hailed a resounding success, exceeding estimates by 250%,**
 - \$45 billion was 2.5x the \$18 billion analyst estimates
- ▶ **Why? New Entrant competition by Designated Entities (DEs)**
 - Fifteen DEs competed aggressively
 - Acquiring \$14 billion of spectrum
 - Represented 4 of the top 7 auction winners
 - Thanks to the 25% DE bidding credit
 - Allowing DEs to compete against large incumbents in a high priced auction
 - Consistent with 21 years of DE Program success
 - DE rules unanimously reaffirmed by FCC Commissioners in July 2014 for Auction 97
 - In short, effective DE competition increased auction proceeds by an estimated \$23 billion
 - \$41 billion of net auction proceeds less \$18 billion of pre-auction estimates
- ▶ **We urge the Commission in the DE NPRM to build on this DE success, insuring in turn that the Incentive Auction succeeds and that New Entrants continue to compete in wireless**
 1. Therefore, adopt 35% DE bid credits going forward
 2. As tentatively endorsed, eliminate the AMR rule that limits DEs to 25% wholesaling & leasing
 3. Reject proposals from large incumbent wireless carriers to relegate DEs to small rural markets

Auction 97's Record Results

Record Auction 97 Pricing (paired spectrum)
(Gross \$ per MHz / POP)



Record Auction 97 Proceeds: \$45 billion
(\$ in billions)



Auction 97 prices (\$ per MHz / POP, paired spectrum) far exceeded expectations and prior auctions:

- 2.1x higher than \$1.29 / MHz / POP in A73 in 2008
- 5.0x higher than \$0.54 / MHz / POP in A66 in 2006

DE competition was responsible for driving record Auction 97 prices and proceeds

- In contrast to Auctions 66 and 73 with low DE participation, low prices and low revenues

With high auction pricing, Auction 97 proceeds far exceeded benchmarks:

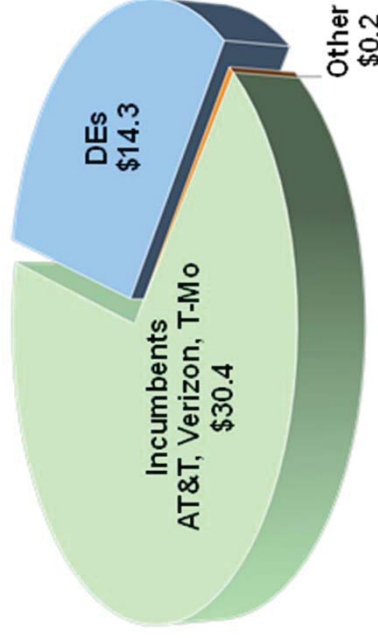
- 2.5x analyst estimates of \$18 billion**
- 4.2x the FCC's \$11 billion reserve price
- 2.3x the \$19 billion Auction 73 in 2008
- 3.2x the \$14 billion Auction 66 in 2006

(**) Commissioner Mignon Clyburn Tweet on 1/29/15: "AWS-3 auction closed. Most predicted \$18 billion; it actually hit \$44.9 billion. Great work by FCC staff, @NTIAgov and Congress!". Also Commissioner Mignon Clyburn statement on 1/29/15: "If you had conducted a poll of analysts before the start of the AWS-3 auction, the highest prediction given for its yield would not have exceeded \$18 billion."

DE Realized Greatly Improved Auction 97 Success

In Auction 97 DEs showed up in solid numbers, with 15 DEs winning licenses and bidding aggressively across the auction

**\$14.3 billion of DE Gross Winning Bids
in the \$45 Billion FCC Auction 97**
(\$ in billions, gross winning bids)



▶ **Auction 97 DE winners included:**

- Northstar – \$7.8 billion
- SNR – \$5.5 billion
- Advantage – \$0.5 billion
- 2014 AWS – \$0.4 billion
- Other DEs – \$0.1 billion

▶ **Other auction winners included:**

- AT&T – \$18.2 billion
- Verizon – \$10.4 billion
- T-Mobile – \$1.8 billion
- Others – \$0.2 billion

Auction 97 Was a Win-Win-Win....

Auction 97's beneficiaries are many, and its detractors are the few, but vocal, Incumbents

▶ Who should be happy with the auction outcome? Virtually everyone:

1. Recipients of the \$41 billion of record net proceeds

- Public Safety (FirstNet) – \$7 billion to deploy a national wireless network for first responders
- U.S. Agencies – \$5 billion to migrate to new spectrum
- Taxpayers (U.S. Treasury) - \$29 billion to reduce national debt

2. Consumers – prospects for New Entrant wireless competition: innovation, pricing

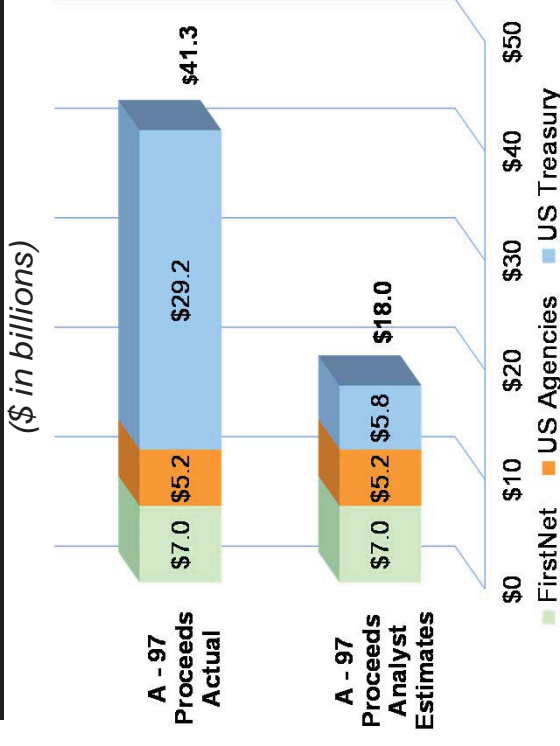
3. Incumbents – happy insofar as they acquired access to very large amounts of new spectrum resources

4. The FCC / BIA – Auction 97 creates a platform for a successful Broadcast Incentive Auction (BIA)

▶ Who is disappointed from high (fair value) auction prices and prospects for future competition?

- Large wireless incumbent carriers (the “Incumbents”)
- They would have preferred the \$18 billion incumbent-dominated auction result anticipated by analysts

Auction 97 Distribution of Net Proceeds



Recommendations for the FCC's DE NPRM

We urge the Commission to build on Auction 97 success as a model for future auction success, notably the upcoming Broadcast Incentive Auction

1. Adopt a 35% DE bidding credit

- 35% is already included in FCC rules, ready for Incentive Auction application
- To promote DE participation in light of the ever-increasing wireless industry concentration
- And in light of the increasing capital intensity of wireless and associated rising barrier to entry

2. Eliminate the 25% limit on DE wholesaling / leasing to any one party (the AMR Rule)

- This limit severely curtails DE business flexibility and funding
- Removal allows DEs the flexibility to pursue new business models with anchor tenants
 - e.g., any number of parties looking for wireless capacity that a new entrant provides

3. The Commission should reject Incumbent “poison pill” efforts to impose new restrictions on DEs as transparent and self-serving efforts to eliminate competition

- Example 1: Incumbents urge re-installing a DE 10-Year Hold Rule
 - Already proven to eliminate DE competition as demonstrated in Auctions 73 and 66
- Example 2: Incumbents propose sizing constraints on DEs
 - e.g., propose capping DE auction bidding credits at low levels
 - e.g., propose capping the size of any single investment in DEs to limit DE access to capital
 - e.g., other similar kinds of un-founded constraints on DE capitalization
 - All designed to ensure that DEs may no longer compete in mid-size and major markets

Recommendations for the FCC's DE NPRM (cont'd)

- ▶ **Our three recommendations will promote robust DE competition in future auctions**
 - Just as we saw in Auction 97
- ▶ **Robust DE participation is critical to the Incentive Auction's success**
 - Promising full, fair value auction pricing as in Auction 97
 - Promising a pathway for future new entrant wireless competitors
 - Benefiting consumers with innovative new services, lower pricing
 - Building on a long line of DE success stories such as T-Mobile, MetroPCS, Leap Wireless
- ▶ **Absent our changes, low competition, low price Auctions 66 & 73 provide a cautionary tale**
 - DE participation in both auctions languished (<4% participation vs. 32% in Auction 97)
 - Auction 66: prices were just 20% of Auction 97 (i.e., \$0.54 vs. \$2.71 / MHz / POP)
 - Auction 73: prices were just 48% of Auction 97 (i.e., \$1.29 vs. \$2.71 / MHz / POP)
 - Low DE participation and low price auctions such as these cost taxpayers billions
 - And foreclose prospective wireless competitors

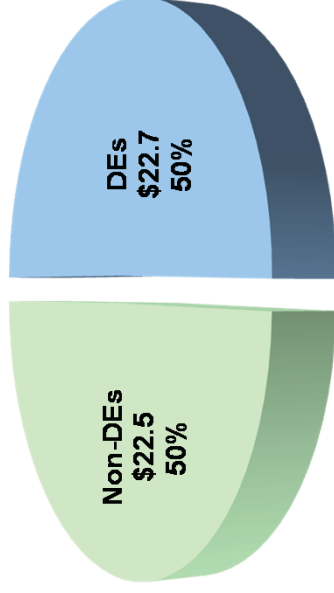
Case Study 1: An Era of DE Success Driving Competition

From 1994 – 2005 DEs were a major factor driving wireless competition, winning \$22 billion of licenses and forming numerous competitive wireless carriers, including T-Mobile

Era 1 ('94-'05): DEs buy \$22 billion of licenses

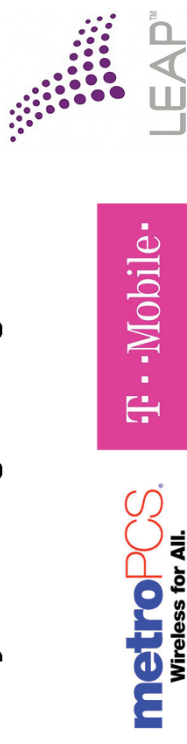
(\$ billions, net winning bids)

**\$22.7 billion in DE Winnings in
64 FCC auctions from '94 – '05
Totaling \$45.2 Billion**



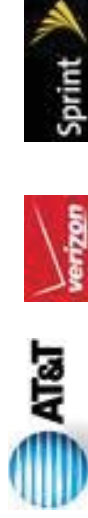
➔ DEs then built many successful carriers

- T-Mobile (Voicestream), Leap, MetroPCS and many others began and grew as DEs



- **New entrant DEs injected real competition into an industry that had been a duopoly**
 - Drove wireless innovation
 - Drove lower wireless prices
 - Competed effectively

- ▶ Incumbent carriers have in the past also commonly partnered with DEs to expand footprints:

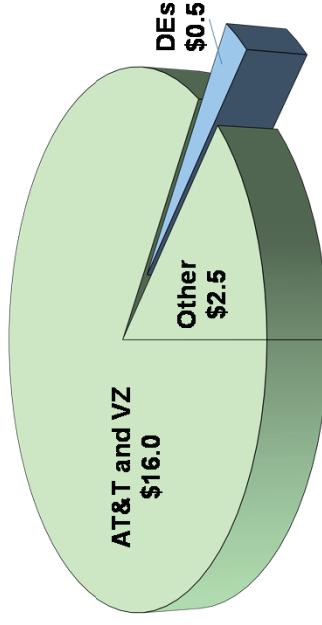


Case Study 2: Cautionary Tale of DE Failure and Low Auction Prices

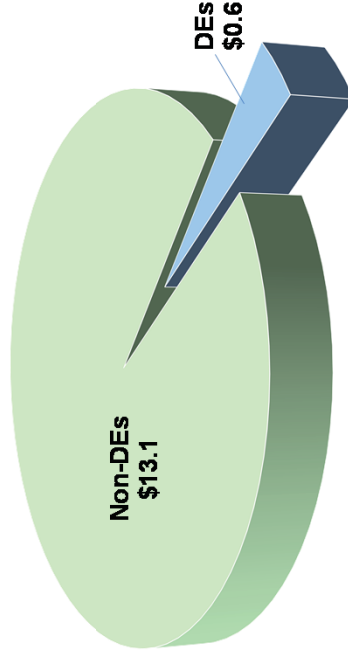
In contrast to earlier DE / auction success, 2006 – 2008 offers a cautionary tale of two major auctions which, bereft of DE participation, resulted in low prices and domination by Incumbents

Era 2 ('06-'08): DEs buy just \$1 billion of licenses as Incumbents dominated two major auctions
(\$ billions; net winning bids)

**Just \$0.5 billion of DE Winnings in the
\$19.0 Billion FCC Auction 73 (2008)**



**Just \$0.6 Billion of DE Winnings in the
\$13.7 Billion Auction 66 (2006)**



- ▶ **Why did DEs fail in these two important auctions? Because of then-new FCC restrictions on DEs**
 - Adopted by the FCC on the eve of Auction 66 in 2006
 - The severe restrictions included a “10-Year Hold Rule” for DEs and a 50% limit on wholesaling, etc.
 - In 2010, after Auction 73, a federal appellate court vacated those restrictions as unlawful
- ▶ **With DEs shut out, large Incumbents dominated and bought spectrum at very low prices**
 - Auction 73 prices were just 48% of Auction 97 – i.e., \$1.29 vs. \$2.71 / MHz / POP
 - Auction 66 prices were just 20% of Auction 97 – i.e., \$0.54 vs. \$2.71 / MHz / POP
 - **Low prices cost the U.S. Treasury and taxpayers billions of dollars in lost auction proceeds**
 - **Incumbent domination prevailed – exactly what Congress directs the FCC to avoid with §309(j)**

Rebuttal of DE Critics:

1. DEs Benefited (Did Not “Cost”) Taxpayers

In some press accounts DE critics claim DEs “cost” taxpayers \$3 billion; to the contrary, DEs were central to netting an extra \$23 billion for U.S. taxpayers

- ▶ The FCC didn’t lose \$3 billion from the DE bid credit, rather it gained \$23 billion
 - \$23 billion equals \$41b in net auction proceeds less \$18b of pre-auction estimates
- ▶ “Auction 101”: more participants, aggressively competing = higher auction pricing
 - DEs represented “more” – DE represented 4 of the top 7 auction winners
 - DEs were “aggressive” – round-by-round bidding results clearly depict DE pricing leadership
 - Auction pricing was higher – Auction 97 pricing was 2.1x Auction 73 and 5.0x Auction 66
- ▶ By contrast Auctions 66 and 73, absent meaningful DE competition, yielded low prices, low revenues and were dominated by Incumbents
 - Auction 66 and 73 DE participation was low
 - DEs winning < 4% of spectrum vs. 32% in Auction 97
 - Auction 66 and 73 prices were low
 - \$0.54 and \$1.29 / MHz / POP, respectively, vs. \$2.71 / MHz / POP (paired) in Auction 97
 - Auction 66 and 73 revenues were low
 - \$13.9 and \$19.1 billion, respectively, vs. \$42.3 billion net in Auction 97
- ▶ Simply put, DEs “paid” for themselves many times over in Auction 97
- ▶ And consumers gained wireless competition – DE innovative services and lower pricing

Rebuttal of DE Critics:

2. DEs Can Be Large in Scale

Incumbent critics now argue that DEs must be relegated to making small bids in the auction, a notion that runs contrary to Congress, FCC and wireless industry rules, intent, history and experience

- ▶ Incumbents “question” how a DE “small business” could win billions of dollars of spectrum
- 1. In 1993 Congress in §309(j) directed the FCC to promote large scale, major market competition
 - Nationwide competition sought to the then wireless duopoly
 - Specifically not limited to small markets
 - Competition in NYC being just as important as in rural Iowa
 - Congress directs the FCC to achieve this by actively managing wireless auctions
 - To disseminate licenses broadly (to NYC and rural Iowa alike)
 - And to prevent license concentration (e.g., Incumbent auction domination)
- 2. The FCC’s policy and rules have long promoted DE partnerships to access large scale capital
 - By encouraging DEs to partner with larger companies and investors
 - To access capital, operating scale and expertise
 - To effectively compete in what is a large scale, capital intensive business
- 3. With FCC support, DEs have raised capital to acquire \$35 billion of licenses over the past 21 years and become major operating carriers
 - T-Mobile, MetroPCS and Leap Wireless as shining examples
 - Bringing new entrant competition to NYC, Los Angeles, Chicago and all major U.S. markets

Rebuttal of DE Critics:

2. DEs Can Be Large in Scale (cont'd)

4. **Incumbent criticism of “large” DEs is belied by Incumbents’ own rich histories of DE partnering**
 - The Incumbents each have histories of partnering with DEs to extend their footprints
 - AT&T – \$2.9 billion DE partnership in Auction 35 in 2001 (Alaska Native Wireless)
 - Also, AT&T’s recently acquired Leap Wireless subsidiary which partnered with DEs, including in Auction 58 (\$68 million) and Auction 66 (\$365 million)
 - Verizon – \$332 million DE partnership in Auction 58 in 2005 (Vista PCS)
 - T-Mobile – \$506 million DE partnership in Auction 35 in 2001 (Cook Inlet)
 - Also, T-Mo participated alongside its DE partner and won \$482 million for T-Mo directly
 - Cingular (now AT&T) – \$2.3 billion DE partnership in Auction 35 in 2001 (Salmon PCS)
 - Sprint – \$282 million DE partnership in Auction 35 in 2001 (SVC BidCo)
5. **Finally, Incumbent criticism of DEs wholly lacks a public interest basis**
 - Such criticisms are not grounded in recognized public policy values
 - e.g., promoting competition, securing higher auctions values for public spectrum, promoting broad participation, avoiding license concentration
 - Their criticisms are narrow complaints that serve their own interest for low auction pricing
 - And foreclosure of future competition

Appendix: DE Program and §309(j)

In 1993 a bipartisan Congress directed the FCC to manage wireless spectrum auctions with the goal of promoting wireless competition – a goal as important today as it was then

- ▶ In 1993 wireless was an RBOC-dominated duopoly, an industry structure Congress rejected
 - Congress instead chose to promote wireless new entrants to compete with duopoly Incumbents
 - Seeking added competition in major markets and smaller markets alike
- ▶ Accordingly, §309(j) of the Communications Act directs the FCC to disseminate licenses broadly and prevent license concentration
 - The FCC shall ensure widespread dissemination of licenses, specifically among small businesses, including minority- and women-owned businesses, and rural telcos (DEs)
 - The FCC shall also protect against excessive concentration of licenses
 - e.g., guard against Incumbents dominating auctions via competition foreclosure premiums
- ▶ In response to §309(j) the FCC currently provides DEs with bidding discounts (e.g., 25%) to promote DE success in acquiring spectrum in FCC auctions
 - And has promoted large scale partnerships to facilitate DE access to capital
- ▶ However, the current DE Program needs additional support to fulfill the §309(j) twin mandates of widespread license dissemination and avoidance of concentration
 - Industry concentration evidenced in the Commission’s annual review of the wireless industry
 - Further supporting the increased 35% bid credit and elimination of the AMR rule
 - Together with rejecting incumbent proposals designed to eliminate large scale DE competitors